

Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

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PLR-110519-20

Date:

October 20, 2020

Association	=
State	=
Statute	=
A	=
B	=
Date 1	=
Date 2	=
Date 3	=

Dear :

This letter responds to a letter from your authorized representative, dated April 17, 2020, and subsequent correspondence requesting a ruling that Association's income is excludable from gross income under section 115 of the Internal Revenue Code (Code). Association represents the facts as follows.

FACTS

Association is an unincorporated association of political subdivisions and agencies of political subdivisions in State (Pool Members). Association was organized to create and administer a group self-insurance pool pursuant to Statute. A operates a comprehensive workers' compensation insurance program for State municipalities and other governmental entities located in State. On Date 1, Association received a ruling that its income from the operation of its group self-insurance pool is excludable from gross income under section 115 of the Code. On Date 2, A received a ruling that its income from the operation of its workers' compensation program is excludable from gross income under section 115. On Date 3, Association and A merged, with Association surviving the merger. The purpose of the merger was to improve risk sharing and to develop greater overall efficiencies by combining overhead expenses, administration, and management.

Association continues the insurance programs that it and A operated prior to the merger using a group self-insurance pool (Pool). More specifically, the Pool provides risk management services and insurance for the Pool Members and employees of the Pool Members for acts or failures to act occurring during the performance of their employment duties. Membership in Association and participation in the Pool is restricted to political subdivisions and agencies of political subdivisions in State. No private persons or organizations can be members of Association.

Association is governed by a supervisory board consisting of six to nine members that are elected by the Pool Members. In addition to the elected board members, the executive director of B is as an ex-officio board member. B is an organization described in section 501(c)(4) of the Code and it was created by various State cities, towns, and counties to promote their welfare. With the exception of the executive director of B, board members must be governing officials or chief administrative officials of political subdivisions that are members of the Pool. Board members cannot be an owner, officer, or employee of a provider of certain services, within the meaning of the Statute, to Association.

Association's income consists of contributions and fees received from the Pool Members, as well as investment income. Association's expenses consist of claim payments, premium payments on certain reinsurance, and the cost of administering the Pool. Any surplus resulting from an excess of income over expenses is retained by Association for use with respect to future claims and other expenses; however, such surplus, or a portion thereof, may be returned to the Pool Members upon the approval of State's insurance commission. No portion of Association's income inures to the benefit of any private person, except as reasonable compensation for goods or services rendered. Upon dissolution or termination, Association's assets must be distributed to the Pool Members.

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under section 115(1) of the Code because such investment constitutes an essential governmental function. The ruling states that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling explains that it may be assumed that Congress did not desire in any way to

restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115(1) of the Code because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excludable from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

Association's activities subsequent to its merger with A consist of the activities both it and A performed prior to the merger. Association was created to provide certain insurance to the Pool Members, which are required to be political subdivisions and agencies of political subdivisions in State. Providing such insurance to such governmental entities constitutes the performance of an essential government function. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

Association's income accrues to political subdivisions of State. Private interests benefit only incidentally. See Rev. Rul. 90-74. In no event, including upon termination, will Association's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excludable from its gross income by application of section 115(1) of the Code.

RULING

Based on the information and representations submitted on behalf of Association, we conclude that, because Association derives its income from the exercise of an essential governmental function, and because Association's income accrues to a state or a political subdivision of a state, Association's income is excludable from gross income under section 115(1) of the Code.

The ruling contained in this letter is based on information and representations submitted by or on behalf of Association and accompanied by a penalty of perjury statement executed by an appropriate party, and on the understanding that there will be no material changes in the facts described above. While this office has not verified any of the material submitted in support of the request for a ruling, the material is subject to verification upon examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving

a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2020-1, section 11.05.

This letter does not address the applicability of any section of the Code or Treasury Regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item of income discussed or referenced in this letter.

This ruling is directed only to Association. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Association's authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, if Association files its returns electronically, Association may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter.

Sincerely,

Kenneth M. Griffin
Chief
Exempt Organizations Branch 3
(Employee Benefits, Exempt Organizations,
and Employment Taxes)

cc: